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Sam Oil, Inc. v. BHP Petroleum (Americas), Inc. and the Utah Board of Oil, Gas, and Mining : Reply Brief

Utah Supreme Court

IN THE UTAH SUPREME COURT

In The Matter of SAM OIL, INC., Petitioner- Petitioner, vs. BHP PETROLEUM (AMERICAS), INC., and THE UTAH BOARD OF OIL, GAS AND MINING, Respondents- Respondents.	Case No. 900327 Priority 15

PETITIONER'S REPLY BRIEF

PETITION FOR WRIT OF REVIEW FROM
THE UTAH BOARD OF OIL, GAS AND MINING

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SUMMARY OF REPLY

Both Respondents, the Board of Oil, Gas & Mining (the "Board") and BHP Petroleum (Americas), Inc. ("BHP"), err in their arguments by assuming that the terms of the Unit Operating Agreement and Unit Agreement address, much less govern, the main question in this case--is Petitioner, Sam Oil, Inc. ("Sam Oil") subject to a non-consent penalty. Sam Oil has appealed the Board's legal conclusion that those contracts impose a non-consent penalty on Sam Oil. The Board and BHP argue only that sufficient evidence exists to support the Board's finding of no exception to the contractual penalty. Yet both BHP and the Board fail wholly to point to any language in those contracts which would require the penalty in the first place. Moreover, both BHP and the Board fail to address the fundamental concept that a penalty is justified, and BHP can avoid liability, only if notice and an opportunity to participate is given.[1] Moreover, the Board's factual findings are not supported by the Record.

In addition, Petitioner questions the standing of the Board to argue affirmance of its own decisions and the propriety of such. Finally, no special deference need be given to the Board's findings or conclusions as the Board has no special expertise with respect

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[1]The Board argues that creation of the Unit in 1950 gave notice to Petitioner's predecessors of the drilling of the subject well and an opportunity to participate. This conclusion was not made by the Board in its Order nor is it supported by any shred of evidence in the Record.

to contractual interpretation or the law regarding non-consent penalties.

ARGUMENT

A. THE BOARD LACKS STANDING TO ARGUE IN THIS MATTER AND ITS BRIEF SHOULD BE STRICKEN.

Rule 14(a) of the Utah Rules of Appellate Procedure requires that "In each case, the agency shall be named respondent." However, that requirement does not necessarily mean that the Board has standing to present arguments in this matter to support its own ruling.

> As a general rule a court or board exercising judicial or quasi-judicial functions, not being a party to its proceedings, and not having any legal interest in maintaining its determination, is not a party aggrieved by a judgment or order reversing its own proceedings, and is not entitled to appeal from such judgment or order, or to be heard on such appeal, under a statute which in general terms authorizes an appeal by any party aggrieved.

4 Am. Jur. 2d, Appeal and Error §234.

Utah's Administrative Procedures Act, Utah Code Ann. §63-46b-1, et seq. (1990), does not provide the agency, from which the appeal is taken, with standing. Rule 14(a) of the Utah Rules of Appellate Procedure requires that the agency be named as a respondent, but does not address the agency's standing to appeal. Sam Oil can only suggest that the purpose for naming the agency is one of notice and simplicity since it should be determined by the Court whether an agency has standing. If the agency has no standing that matter should be brought to the Court's attention by

a motion to strike. There are no reported Utah decisions dealing with this issue.

The issue has been addressed by the New Mexico Supreme Court. Continental Oil Company v. Oil Conservation Commission, 373 P.2d 809 (N. Mex. 1962) In that case, the Oil Conservation Commission had been denied the right to actively participate in an appeal of its gas proration order to the trial court. The New Mexico court recognized the distinction between an agency's administrative function and its judicial function. With respect to the former, the agency acts to represent the public's interests and is therefore a proper party to an appeal. In the latter case, the agency sits as a court in resolution of private disputes between parties. If no public interest is being protected or forwarded by the agency, it is not a proper party to an appeal.[2]

This matter was brought before the Board by Sam Oil seeking an accounting of revenues produced from a well operated by BHP pursuant to Utah Code Ann. § 40-6-9 (1989). The statute is "a unique conservation statute in that it provides a forum for Board resolution of production payment and royalty interest disputes between private parties." D. Dragoo and R. Storey, Utah's

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[2]"Thus, in regard to quasi-judicial agencies with simply the functions of finding facts and applying the law to the facts, and where no statute provides otherwise, the courts have held that the agency is without right to appeal from such decision, the administrative agency being in no different position from a court or judge which has rendered a decision." 2 Am. Jur. 2d Administrative Law §774 (1962).

Oil and Gas Conservation Act of 1983, 5 JOURNAL OF ENERGY LAW & POLICY 49, 65. The statute was a re-enactment of a prior similar provision that "involved the Board in private contractual disputes in which the state had no identifiable interest. That remedy was separate and apart from the Board's activities regulating the efficient production of the State's oil and gas resources." Id.

No public interest, other than swift adjudication of private rights, is involved here. The question presented to the Board concerns only entitlement to money as between two private parties. The Board was not asked to apply any statute or rule to this controversy until it had first determined that the failure to pay Sam Oil was without reasonable justification. Utah Code Ann. §40-6-9. The Board considered only the contract between the parties and common law principles. Indeed, Sam Oil could have brought this matter before a trial court of this state. Accordingly, the Board was acting solely in a judicial role and should not be allowed to participate in this appeal. By separate motion, Sam Oil has respectfully requested that the Board's Brief be stricken and not considered by the Court.

B. NEITHER THE UNIT AGREEMENT NOR THE UNIT OPERATING AGREEMENT PURPORT TO GOVERN THE IMPOSITION OF A NON-CONSENT PENALTY ON A PARTY WHO JOINS THE UNIT AFTER A WELL IS COMMENCED.

Both the Board and BHP premise their entire arguments and positions on the premise that either the Unit Agreement or the Unit Operating Agreement, as amended, require the imposition of a

penalty on Sam Oil. They do not argue that imposition of a penalty is based on anything other than those two agreements. However, the Board and BHP fail to address the total absence of any provisions in the Unit Agreement and Unit Operating Agreement which even address this situation, much less justify the imposition of a non-consent penalty on Petitioner. The only provision in either agreement addressing a non-consent penalty is Section 9 of the Unit Operating Agreement. (Ex. 16; Add. "D" 27-28)[3] That provision permits a non-consent penalty only when notice is given containing specifics of a proposed action such as drilling a well. The penalty is only allowed under those circumstances. It is uncontested that no such notice was given to Sam Oil or its lessor.

Nor does the Unit Agreement govern this dispute. Both BHP and the Board refer to Section 27 of the Unit Agreement. (R. 248-9) That provision concerns only the process of joinder and does not address any penalty or other aspects of the allocation of costs and revenues. Indeed, the Bureau of Land Management, the governing federal agency, stated before the Board that it has no interest in the allocation of the costs and revenues among working interest owners. (R. 203-210)

Contrary to BHP's belief, this case involves much more than factual questions. Indeed, it is the Board's error on the

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[3]Addenda references are to the Addenda to Sam Oil's principal brief.

application of the agreements that has brought on the misdirected discussion regarding an "exception" to the imposition of a penalty and the ensuing dispute regarding what Sam Oil knew and when it knew it. The Board erred when it decided that as a general rule the Unit Agreement and Unit Operating Agreements (both attached as addenda to the Board's Brief) required the imposition of a penalty on Sam Oil. Those contracts do not address the imposition of a penalty on a party in a unit who joins the unit after it is created and wells are drilled. Notably, neither BHP nor the Board cite any authority supporting the Board's decision. Neither the Board nor BHP refute Mr. Lear's expert testimony that (i) subsequent joinder was not addressed at all in the Unit Operating Agreement, the sole contract which addresses a non-consent penalty (TR1. 121), and that (ii) absent notice, no penalty is appropriate unless fairness would require a penalty, i.e. some equitable substitute for notice exists such as actual knowledge--the "equitable exception" of which Mr. Lear spoke and of which the Board and BHP are so utterly confused (TR1. 123-4).

Accordingly, for a penalty to have been properly imposed under the agreement, notice and an opportunity to participate are required. See, Section 9 of the Unit Operating Agreement and Add. "D" 27-29. Not only does the Unit Operating Agreement require notice with respect to parties to the Agreement, but the common law and notions of due process require the same in the absence of an

agreement. Either view of Sam Oil's position requires notice. To avoid that result BHP, not Sam Oil, must show equitable considerations which would justify a penalty.

The Board and BHP ignore the express terms of the agreements and argue that a penalty is equitable based on a presumption that the Unit could not have been created without notice to all parties owning land within the geographic area of the Unit, and that Sam Oil and its predecessors in interest, therefore, must have received notice and refused an opportunity to join the Unit denying the thirty years prior to this dispute. This argument fails for a number of reasons.

First, there is no evidence that the regulation cited by the Board and BHP (43 C.F.R. §3181.3) was in existence in 1950 when the Unit was created. Second, there is no evidence that Sam Oil's predecessors were actually given notice and refused to join as is required by the regulation cited by the Board and BHP. Third, the Unit Operating Agreement requires a specific notice in writing with specific information upon which a party can make an intelligent decision to participate in the drilling of a well. The "notice" argued by the Board does not come close to meeting the specifics of the notice required by the Agreement.

Fourth, the argument lacks contractual logic. On the one hand, the Board argues that since Sam Oil was not a party to the Unit Operating Agreement prior to commencing the Well, BHP had no

contractual duty to give Sam Oil or its lessor notice. Yet on the other hand, even though Sam Oil was not a party to the Unit Operating Agreement, the Board argues that the penalty in the Agreement should be imposed. This argument foists the burden of the penalty on Sam Oil without the benefit of the contractual notice requirement. BHP can not have it both ways.

Finally, BHP had notice of Sam Oil's request to join the Unit and participate in the subject Well. Yet BHP did nothing to advise Sam Oil that it would be subject to a penalty or otherwise condition Sam Oil's joinder on the imposition of a penalty. Accordingly, the presumed "notice" argued by the Board, if there ever was any, is not notice sufficient to justify a penalty. BHP could have protected itself early on by creatively dealing with an unusual situation and allowing Sam Oil's participation and accepting its share of the costs up front, contingent on joining the Unit. Instead, BHP lamely argues that its was only following the rules set by the federal government; which in fact set no such rules.

The Board's lengthy discussion of the differences between federal and state unitization or pooling terminology does nothing to help solve the questions presented in this case. The Board's argument is a distinction without a difference given that the federal government is not concerned with the allocation of costs and revenues. A more appropriate standard for that resolution are

the fundamental principles of fairness and due process which are not dependent on any federal/state distinction. The authorities and arguments discussed in Sam Oil's Brief, based on those notions, are applicable and controlling.

Sam Oil is not required to show any exception to the contracts since those contracts do not deal with the situation. The Board's fundamental error is its conclusion that the Unit Operating Agreement states a "general rule." Contracts do not state general rules; they state specific rules that govern the actions of the parties. The contracts in this case contain no specific rules governing this situation. Common law states general rules. In this case, common law requires that notice and an opportunity to participate be given before a penalty is imposed. Sam Oil is not asking that it participate for free. It expressed its willingness to pay its share of costs at an early stage. It is only asking that it not be subject to a penalty when it had no real opportunity to avoid it.

C. SAM OIL HAD NO KNOWLEDGE PRIOR TO COMMENCEMENT OF THE WELL WHICH WOULD SUBSTITUTE EQUITABLY FOR THE NOTICE REQUIRED BY THE UNIT OPERATING AGREEMENT OR LAW.

Most of the dispute with respect to the Board's findings concern what Sam Oil knew and when it knew it. The essence of the two express findings of the Board (Finding No.'s 3 and 4; R. 448; Add. "A" 3) and the implicit finding that Sam Oil purposefully delayed ratification ("The ratification was not signed until well

after it was received and after the well had been completed.") (TR1. 281; Add. "C" 11), are the main focus of Sam Oil's appeal of the Board's factual findings. Sam Oil has attacked those express and implied findings of fact since it is clear that the Board relied on them in dismissing Sam Oil's petition.

The Board has argued first that those findings are not necessary to support the Board's Orders (Board's Brief at 32).[4] Then the Board argues that it made its findings based on its conclusion that Sam Oil's principal witness, Steven Malnar, was not credible. However, the record lacks any evidence to dispute Mr. Malnar's testimony and to support the Board's disputed findings. Those findings must be supported by substantial evidence, not just a disbelief of testimony in the absence of supporting evidence. Moreover, the supposed "egregious samples of testimony" (Board's Brief at 32-33) do not evidence any lack of credibility.[5]

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[4]If that statement is correct, the Court should ignore those findings and decide this case assuming that no evidence supports these findings.

[5]As expressed above, Sam Oil has significant concern with the propriety of the quasi-judicial body appealed from, the Board, arguing before the appellate court that it considered witnesses to not be credible. Mr. Malnar frequently appears before the Board. It is impossible for Sam Oil to ascertain whether the Board's disbelief of Mr Malnar is based solely on his testimony in this matter or may be based on other matters. Accordingly, Sam Oil believes it is prejudicial for the Board to take an adversarial role in interpreting and arguing the record in this case. In any other case, would the appellate court permit a juror or the trial judge to argue the credibility of witnesses on appeal?

BHP convinced the Board, and would have this Court believe, that the evidence shows that Sam Oil intentionally delayed joinder or commitment in order to obtain knowledge regarding the subject well prior to committing. The evidence does not support that conclusion. First, as argued in Sam Oil's Brief and not refuted by the Board or BHP, Sam Oil could not have joined the Unit any earlier than it did due to delays by the Unit Operator, Rio Bravo Oil Company, in forwarding the necessary joinder documents to Sam Oil. Indeed, the Well was completed before Sam Oil even received those documents. The Well was completed on January 16, 1984 (Finding No. 9, Add. "A" 4); Sam Oil received the documents on January 9, 1984 (R. 395). Second, Sam Oil had no knowledge of the success of the well prior to signing the ratification documents and joining the Unit. Mr. Malnar had been told that the well was good, but that characterization is inconclusive. Indeed, BHP admits that it had no idea what Mr. Malnar knew. (TR1. 223-224)

Likewise, Sam Oil did not know of the unleased Robertson acreage in May of 1983 or prior to commencement of the drilling of the Well. In May 1983 Mr. Malnar discovered that land in the Unit was subject to a Tenneco Oil Company lease. (TR1. 79; R. 396-7) It was not until September 1983 that Mr. Malnar discovered the unleased acreage of Hazel Robertson and obtained the first lease from her on September 29, 1983. (R. 396-7; TR1. 48) Accordingly, Mr. Malnar did not even have any rights to assert prior to

commencement of the Well on September 11, 1983. If Mr. Malnar knew in May 1983 of the unleased Robertson acreage, why would he have risked not being able to convince Ms. Robertson to lease if he had planned to sit back and wait to see the results of the Well. Why would he not have waited until after the Well was completed to seek joinder? Why would he have contacted BHP before completion? These questions show the weakness in the Board's factual findings.

No evidence exists to suggest, much less prove, that Mr. Malnar had any knowledge of the Well proposal prior to September 11, 1983, or that production from the proposed Well would possibly benefit the Robertson property since it was located quite some distance from the Well site in another section of land.[6]

This Court must remember that it is undisputed that neither Mr. Malnar nor Ms. Robertson were contacted with any proposal to drill the Well. Once Mr. Malnar acquired the lease for Sam Oil, in October 1983 he diligently contacted all parties who might give him information concerning participation in the Unit and any wells in the Unit. (Ex.'s 2 and 4) The unavoidably delayed ratification

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[6]BHP suggests that Mr. Malnar testified that he learned about deep wells in the Unit prior to September 11, 1983. (BHP's Brief at 11) Even the language quoted by BHP shows Mr. Malnar did not know where any well was proposed and that a lot of wells were drilling. Moreover, Mr. Malnar testified "I believe Don Johnson told me prior to <u>this</u> that there was a possibility of some deep wells being drilled in the Roosevelt Unit." (TR1 81, emphasis added) The "this" referred to is Mr. Malnar's discussions with Ms. Robertson during negotiations of the second lease in <u>November</u> 1983. (See Sam Oil's Brief at 28-29)

process followed.

The totality of the facts before the Court do not support the Board's findings. It is incredible to believe that Mr. Malnar could have masterminded a scheme as elaborate as that attributed to him by the Board and BHP. Too many other actors were involved (Ms. Robertson, Rio Bravo Oil Company, BHP and Sam Oil's title researcher, to name a few) and too much risk existed. Each of the supposed samples of incredibility, or support for the Board's findings argued by the Board and BHP, has an equal or better explanation in light of the whole record. Mr. Malnar simply stumbled across a leasing opportunity and acted diligently to participate in the Unit. The timing was not of his design or doing. He was merely following "the rules."

While BHP and the Board may attack and twist Mr. Malnar's testimony to suit their needs, their arguments are most incredible in the face of the total absence of any evidence or testimony in the record supporting their arguments. BHP produced only one witness, Jerry Bair, who admittedly had no personal knowledge of any facts whatsoever. BHP relies solely on its cross-examination of Mr. Malnar and its improper conclusions therefrom. If Mr. Malnar were not a credible witness, his testimony should not be considered. If his testimony is not considered, there is no testimony supporting the Board's decision. Sam Oil submits that such logic does not produce the "substantial evidence" required to

support the Board's findings. Accordingly, this Court should reverse those findings.

D. NO SPECIAL DEFERENCE NEED BE GIVEN TO THE BOARD'S CONCLUSIONS OF LAW.

Both the Board and BHP have argued that this Court must defer to the Board's legal conclusions due to its expertise. Sam Oil submits that the Board has no special expertise in deciding matters concerning private contractual disputes. This matter did not require the Board to exercise any special expertise regarding oil and gas reserves, geographic information or production information. The question before the Board was simple, did the contracts between the parties require the imposition of a non-consent penalty on Sam Oil? By its own admission, the Board did not even reach the question of applying the statute (Utah Code Ann. §40-6-9) applicable to this matter. (Conclusion No. 5; R. 451) The fact that Sam Oil could have properly brought this matter in a trial court instead of before the Board evidences that no special expertise is needed.

Moreover, the Board did not exercise an administrative function in this case; its role was purely judicial. Granted, some understanding of oil and gas law is helpful to the resolution of this matter. However, acquiring that understanding is nothing that wouldn't be asked of any judicial body. There is nothing special about the constitution of the Board that suggests that its members have any more expertise in deciding contract disputes than does

this Court. For this Court to grant any degree of deference to the Board's legal conclusions, this Court must conclude that it is not as capable as the Board in interpreting the common law concerning contractual disputes in the area of oil and gas law. Sam Oil submits that is not the case.

Finally, BHP's argument that the Board has special expertise in this matter is wholly inconsistent with its position taken before the Board. Prior to the August 24, 1989, hearing before the Board, BHP filed a federal interpleader action and sought an order from the Federal District Court staying the Board hearing on jurisdictional grounds; that motion for stay was denied. (R. 221-317; TR1. 36) BHP argued that this dispute concerns contractual issues as to the effect of the non-consent provision in the agreements between the parties. (TR1. 13) BHP sought to exclude those issues from the Board's consideration. The Board, however, ruled that it had discretion to hear contractual disputes as an adjunct to its authority under Utah Code Ann. § 40-6-9. (TR1. 40-41). BHP's argument that the Board had some special expertise in resolution of these contractual issues is absolutely contrary to its prior position. BHP should be estopped from now arguing that the Board has some special expertise requiring this Court's deference.

CONCLUSION

The fundamental err committed by the Board was its legal

conclusion that Sam Oil was subject to a non-consent penalty as a "general rule" without any basis existing therefor in the contract between the parties. Sam Oil does not need to show any "exception" to avoid a non-consent penalty; no penalty was applicable in the first case. Sam Oil complied with every request in joining the Unit and seeking an opportunity to participate in the Well, only to be told it had to pay a 200% bonus to BHP. Sam Oil had no knowledge of this penalty going in. BHP could have taken a number of steps to protect its interests. It could have objected to Sam Oil's joinder, required that Sam Oil's joinder be conditioned on acceptance of the penalty, or accepted Sam Oil's proportionate share of the costs of drilling, completing and equipping the Well up front, contingent on admission to the Unit. Sam Oil did not sleep on its rights; rather, BHP took advantage of a situation to reap a windfall from Sam Oil's share of production.

Fundamental principles of due process and fairness require that the Board's Orders be reversed and that the Board be directed to enter an Order finding Sam Oil entitled to its share of revenues and requiring BHP to justify its withholding of payment of those revenues, subject to the remedies and penalties prescribed under Utah Code Ann. § 40-6-9.

DATED January 16, 1991. ANDERSON & WATKINS

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CERTIFICATE OF SERVICE

I hereby certify that I mailed, first class, postage pre-paid, a true and correct copy of the foregoing **PETITIONER'S REPLY BRIEF** this 16th day of January, 1991 to the following:

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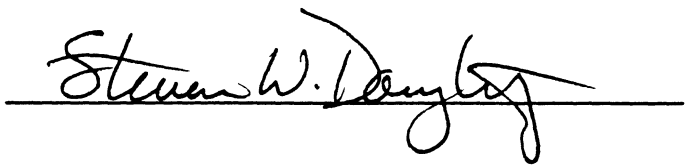

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